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MICHAEL RODAK JR. CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

NO. 73-1657

ESTATE OF JOSEPH M. MEADE, DECEASED,
FIRST NATIONAL BANK OF FLORENCE, EXECUTOR,
and HAZEL B. MEADE,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE

WILLIAM S. and ELIZABETH KING,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE

SUPPLEMENT TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

J. Gilmer Blackburn
P. O. Box 757
Decatur, Alabama 35601

COUNSEL FOR PETITIONERS

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Petitioners would like to call the urt's attention to a case note on the above yled case, published after the filing of e Petition for Writ of Certiorari. The se note is a Rewrite Bulletin, published part of 9 CCH 1974, Fed. Tax Rep., para- aph 8164, p. 75,351. The Rewrite Bulletin reproduced for the convenience of the urt and attached herewith as Exhibit A.

The Standard Federal Tax Reporter is one of the leading tax publications in the United States. A Rewrite Bulletin is an editorialized statement by the editors of this report on timely tax matters of national importance. This article reflects the nationwide interest in this case. The case note also recognizes the direct conflict between the Court of Appeals for the Fifth Circuit and the United States Tax Court and the Court of Appeals for the Second Circuit. The article concludes with the comment that "Supreme Court review of the current decision would be immensely helpful."

Respectfully submitted,

J. Gilmer Blackburn
P. O. Box 757
Decatur, Alabama 35601

COUNSEL FOR PETITIONERS

CERTIFICATE OF SERVICE

I hereby certify that on the 31st day of July, 1974, three copies of the Supplement to Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit was mailed, postage prepaid to Robert Bork, Solicitor General, Department of Justice, Washington, D.C. 20530.

J. Gilmer Blackburn
P. O. Box 757
Decatur, Alabama 35601

Counsel for Petitioners

EXHIBIT A

Rewrite Bulletin, 9 CCH 1974, Fed. Tax Rep. paragraph 8164, P. 75,341, LEGAL COSTS ORIGINATED IN LIQUIDATION--NO DEDUCTION.

Through the years, the U.S. Supreme Court has made it clear that the deductibility of legal expenses depends on the origin of the claim from which they arose, not on the purpose of the litigation: In 1963, the Court held[1] that the expense of defending a divorce action was not a deductible cost of conserving income-producing property because the claim arose from the marriage relationship, although it could have affected the taxpayer's business holdings. In 1970, the Court ruled[2] that legal expenses incurred in appraisal proceedings in connection with a required purchase of dissenting shareholders' stock were non-deductible capital expenses because they were part of the cost of acquiring the stock, which was a capital asset.

NOT SO EASY

Lest it be supposed that the "origin" test is an easy one to apply, attention should be drawn to a recent decision of the U. S. Court of Appeals at New Orleans.[3] This court has ruled that legal expenses incurred in prosecuting an antitrust suit were capital expenses because the taxpayers had acquired their claim upon liquidation of their corporation, which had occurred a year before the suit was settled.

In so ruling, the Court squarely differed with the Tax Court's application of the test and may have broadened it considerably. The taxpayers have requested the Supreme Court to review the case.

WHAT HAPPENED

The taxpayers were the sole shareholders of a wire company. In 1963, their attorney advised them that a competitor had violated the antitrust law. In 1965, after they liquidated the wire company, the shareholders brought an antitrust action against the competitor and recovered $900,000. Large amounts of legal expenses were incurred; these the shareholders attempted to deduct as expenses incurred in the collection of income.

WHAT WAS ORIGIN?

The Tax Court decided that the "origin" of the claim refers not to the mode of acquisition, but to the event that gave rise to the claim and that here that event was the competitor's violation of the antitrust laws.

However, the appellate court decided that the origin of the claim was the disposition of the stock in the liquidation. Because the stock was a capital asset, the legal fees were a capital expense. The court felt that the claim was a part of the assets the shareholders acquired from the corporation and, until they disposed of it one way or the other, the transaction remained "open" for tax purposes. The Tax Court's rationale was not explicitly discussed, although the appellate court obviously felt that--within the framework set out by the Tax Court--"origin" does indeed refer to the mode of acquisition, not the event that gave rise to the claim. The liquidation did not in any sense "create" the claim but, if anything, merely passed it to the taxpayers.

In this connection, the appellate court's decision was correct in deciding that the

shareholders in fact "acquired" the claim in the liquidation was in line with frequent decisions that even a sole shareholder may not bring a private antitrust suit against a competitor, but that this right belongs solely to the corporation.[4]

EFFECTS OF PRIOR AGREEMENT

The two courts also differed over the effect of a 1964 decision of the U. S. Court of Appeals for the Second Circuit (New York).[5] There, a corporation had contracted to distribute and exhibit three motion pictures another corporation (Argosy) was to produce. A dispute later arose about the amount of the proceeds to which Argosy was entitled, but it was liquidated before the dispute could be settled. The taxpayer, a shareholder, received a portion of the claim in redemption of his stock and later incurred legal expenses in settling it. The New York court permitted a deduction, and the case has been assumed to stand for the proposition that legal expenses paid to collect income are deductible even though the income is capital gain.

The Tax Court felt that this precedent was decisive in the instant case. The appellate court, however, although conceding that the 1964 decision was "distinguishable" from the Supreme Court's 1970 opinions, ruled that it was also distinguishable from the instant case because the litigation there involved only the interpretation and enforcement of previously-existing agreements. Here, by contrast, establishment of the value of the antitrust claim was a contingency upon which the finality of the taxpayers' stock disposition depended.

This may be a distinction without a

difference because all parties agreed in the 1964 case that the claim there had no ascertainable fair market value at the time of liquidation, which was the reason the transaction remained "open" for tax purposes. Thus, it could be argued that the litigation there was every bit as essential in establishing a value for the acquired stock.

STATE OF THE LAW

As the law now stands, perhaps the safest statement is that shareholders who incur legal fees in connection with litigation involving their stock should be aware that the expenses may not be deductible. Supreme Court review of the current decision would be immensely helpful. Back References: ¶2006.0915, 2006.316, and 2219.3093.

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[1] Gilmore, 63-1 USTC ¶9285,372 U.S. 39.

[2] Woodward, 70-1 USTC ¶9348,397 U.S. 572; Hilton Hotels, 70-1 USTC ¶9349,397 U.S. 580.

[3] Meade Est., (CA-5) 74-1 USTC ¶9237, rev'g 31 TCM 935, Dec. 31,526(M), TC Memo. 1972-190.

[4] See, e.g., Skoras Theaters Corp. v. RKO Corp., (DC) 193 F Supp. 401.

[5] Doering, (CA-2) 64-2 USTC ¶9593,335 F2d 738.